

**Letter of Findings: 09-0324 & 09-0897
Corporate and Individual Income Tax
For the Years 2005, 2006, and 2007**

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ISSUES

I. Corporate and Individual Income Tax – Imposition.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-5-4; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayers protest the imposition of additional income tax.

II. Tax Administration – Underpayment Penalty and Negligence Penalty.

Authority: [IC 6-3-4-4.1](#); IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayers protest the imposition of the underpayment penalty and negligence penalty.

STATEMENT OF FACTS

Taxpayers, a married couple, are shareholders owning sixty (60) percent of an Indiana S corporation, which sells and distributes snack items, including chips, pretzels, and cookies. Pursuant to an audit, the Indiana Department of Revenue ("Department") discovered that the S corporation failed to retain adequate records and to file proper corporate income tax returns for 2005, 2006, and 2007. The Department's audit, thus, adjusted the S corporation's income based on the best information available at the time of the audit. The audit's adjustment resulted in an increase of corporate net income, which, in turn, passed through to Taxpayers, the shareholders. The Department, thus, assessed Taxpayers additional income tax, interest, as well as underpayment and negligence penalty as a result of the audit.

Taxpayers protested the assessments. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary. Please refer to Letter of Findings 09-0898 regarding further information and issues raised by the S corporation's related sales and use tax protest.

I. Corporate and Individual Income Tax – Imposition.

DISCUSSION

During the audit, upon examining the S corporation's records and its corporate income tax returns, the Department discovered that, in addition to several mathematical errors in its returns, the S corporation erroneously claimed "vehicle loan payment" and claimed deductions twice on "spoiled goods." The Department's audit also noted that the S corporation failed to maintain adequate records in order to substantiate its alleged business expenses for these years. Additionally, the Department's audit noted that while Taxpayers consistently carried over the S corporation's net operating losses during these years, both the S corporation and its shareholders did not keep records concerning the shareholders' basis. Taxpayers, to the contrary, asserted that the S corporation's income was less than what the Department's audit deemed.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

IC § 6-8.1-5-1(b), in part, states "[i]f the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to IC § 6-8.1-10 concerning the imposition of penalties and interest."

IC § 6-8.1-5-4 provides:

(a) Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

(b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person has filed:

(1) For an unlimited period, if the person fails to file a return or receives notice from the department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return.

(2) In all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the department consents to earlier destruction.

In addition, if the limitation on assessments provided in section 2 [[IC 6-8.1-5-2](#)] of this chapter is extended

beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.

(c) A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times.

(d) A person must, on request by the department, furnish a copy of any federal returns that he has filed.

After an administrative hearing, Taxpayers were afforded additional time to submit documentation to substantiate their claim. Taxpayers, however, only provided a statement which stated:

The figures that the IDOR auditor supplied were not even close to any prior year tax returns. The auditor also stated that she was not supplied with the proper paperwork, so therefore she had to estimate on most of the figures of the audit. The auditor was supplied with all requested documents, so estimating should not have played such a large role in the audit.

Given the totality of circumstances, in the absence of other documentation, the Department is not able to agree with Taxpayers that they have met their burden demonstrating the Department's proposed assessment is wrong.

FINDING

Taxpayers' protest on the imposition of additional income tax is respectfully denied.

II. Tax Administration – Underpayment Penalty and Negligence Penalty.

DISCUSSION

Taxpayers protest the imposition of the underpayment penalty and negligence penalty.

A. Underpayment Penalty

The Department imposed an underpayment penalty because Taxpayers failed to timely remit their estimated payments of adjusted gross income tax pursuant to IC § 6-3-4-4.1.

IC § 6-3-4-4.1, in pertinent part, states:

(a) Any individual required by the Internal Revenue Code to file estimated tax returns and to make payments on account of such estimated tax shall file estimated tax returns and make payments of the tax imposed by this article to the department at the time or times and in the installments as provided by Section 6654 of the Internal Revenue Code. However, the following apply to estimated tax returns filed and payments made under this subsection:

(1) In applying Section 6654 of the Internal Revenue Code for the purposes of this article, "estimated tax" means the amount which the individual estimates as the amount of the adjusted gross income tax imposed by this article for the taxable year, minus the amount which the individual estimates as the sum of any credits against the tax provided by [IC 6-3-3](#).

...

(b) Every individual who has adjusted gross income subject to the tax imposed by this article and from which tax is not withheld under the requirements of section 8 [[IC 6-3-4-8](#)] of this chapter shall make a declaration of estimated tax for the taxable year. However, no such declaration shall be required if the estimated tax can reasonably be expected to be less than one thousand dollars (\$1,000). In the case of an underpayment of the estimated tax as provided in Section 6654 of the Internal Revenue Code, there shall be added to the tax a penalty in an amount prescribed by [IC 6-8.1-10-2.1](#)(b).

Taxpayers have provided sufficient documentation demonstrating that the imposition of the underpayment penalty is not appropriate.

B. Negligence Penalty

Taxpayers also protest the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a tax return;
- (2) fails to pay the full amount of tax shown on the tax return;
- (3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
- (4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

[45 IAC 15-11-2](#)(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), in part, as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause,

the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

In this instance, Taxpayers maintained that "[t]he Indiana Tax Code is not written so that the lay person would easily be able to file their own [] personal taxes without the fear of repercussions." Submitting copies of the S corporation's 2006 and 2007 corporate income tax returns, Taxpayers asserted that they "relied on [a] Certified Public Accountant (CPA) to be competent enough in his job to file [the S corporation's] corporate tax return" since the "State of Indiana was willing to certify him as a CPA because of his competency level."

Taxpayers are mistaken. While Taxpayers employed the accountant, as their agent, on behalf of Taxpayers, to ensure their compliance of the Indiana statutes, Taxpayers, as the principals, were responsible for their agent's compliance failure. Aside from their assertion, Taxpayers did not provide documentation to establish that their failure to pay tax or timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayers' protest on the underpayment penalty is sustained. However, Taxpayers' protest on the negligence penalty is respectfully denied.

SUMMARY

For the reasons discussed above, Taxpayers' protest on the underpayment penalty is sustained. However, the remainder of Taxpayers' protest is respectfully denied.

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